Executive Registry
85- 709

CSIS

Center for Strategic & International Studies
Georgetown University • Washington DC

20 February 1985

The Honorable William J. Casey
Director,
The Central Intelligence Agency
Washington, D. C. 20505

Dear Bill,

I have been informed that at some point next week (probably on Monday or Tuesday, February 25 or 26), you will be meeting with a group of visiting Canadians -- all of whom are members of Canada's Business Counsil on National Issues (BCNI). As a result of some work that CSIS has been doing for the BCNI, under my direction, I have some background on that meeting which you may find helpful -- hence this letter and its attachments.

3:30

Said attachments include (1) a xerox of a BCNI brochure describing that organization's genesis, functions and membership; and (2) a copy of a study the Center has just done for the BCNI entitled "THE VIEW FROM THE SOUTH: Key Bilateral Issues Affecting US-Canadian Relations, As Seen From A US Perspective".

This forthcoming (23-24 February) weekend, the BCNI -- in co-operation with Time, Inc. -- is bringing a group of about two dozen BCNI members (each the CEO of a major Canadian corporation) to Washington for a three day series of "introduction the second Reagan administration" meetings and discussions. As I understand it, you are one of those with whom this group is scheduled to meet. All members of that group have received our attached study, and by the time they get to Washington will presumably have read it. You are of course most unlikely to get any questions on the study itself; but it may be fresh in your visitors' minds and you could conceivably get some questions directly or indirectly stimulated by it.

I do not know precisely which BCNI members (hence Canadian CEOs) will comprise next week's delegation, but said delegation will be headed by the BCNI's own President and CEO -- Thomas P. d'Aquino. Tom is a youthful (mid-40's), impressively able and hard-charging lawyer/business consultant (not a scholastic philosopher), very well wired into the Canadian government -- particularly the new Mulroney government. Tom is multi-lingual (easily, interchangeably fluent in English, French, German and Italian) and a very engaging fellow, whom you will enjoy meeting if you do not already know him.

At Tom's request, I have laid on a "pulling all threads together" discussion and seminar at CSIS for this group -- which will convene at 9:00 Wednesday morning, 27 February in our conference room in suite 400 at 1800 K Street and last for ninety minutes (i.e. until 10:30). Since Tom told me the group's main interests are trade, energy, defense and Congressional attitudes, I have set up a three-

1800 K Street Northwest, Suite 400 • Washington, DC 20006 • Telephone 202/887-0200
Cable Address: CENSTRAT TWX: 7108229583

D 310 DCI EXEC REG

person panel: Bill Merkin, Brock's Deputy for Canadian matters, who will give a US-Canadian trade picture overview; my CSIS suitemate Jim Schlesinger, who will cover energy and defense; and Ken Myers -- another friend and a former CSIS colleague, now a senior member of the Senate Foreign Relations Committee staff -- who will limn the view from Capitol Hill.

I have discussed all this with Rick Burt, with Don Gregg, and with Ty Cobb (of the NSC staff) -- all of whom have been very supportive and each of whom may attend our 27 February seminar or send a representative/observer to it. If you or Bob Gates would also like to send such a representative/observer, you are more than cordially invited to do so.

I hope this is of some help and background utility.

With, as always, warmest personal regards,

Sincerely,

George A. Carver, Jr.
Senior Fellow

GAC:sc

Enclosures

CENTER FOR STRATEGIC &
INTERNATIONAL STUDIES
GEORGETOWN UNIVERSITY

Approved For Release 2009/12/29 : CIA-RDP87M00539R002904800040-2

THE VIEW FROM THE SOUTH:

Key Bilateral Issues Affecting US-Canadian Relations, As Seen From A US Perspective

12 February 1985

This study was done for the Business Council on National Issues by a working group at the Center for Strategic and International Studies (CSIS), Georgetown University, Washington, D. C., USA

The section on "Trade and the US-Canadian Economic Agenda" was drafted under the supervision of John Yochelson (Director, International Business and Economics Programs), assisted by Margaret Trimble.

The section on "Prospects for US-Canadian Energy Relations" was jointly drafted by Charles Ebinger (Director, Energy and Strategic Resources) and Jonathan B. Stein (Fellow in Energy and Defense Studies), and reviewed by G. Henry M. Schuler (Director of the Bartlett Council on Energy and National Security).

The section on "Protecting Our Shared Continent: Canadian-US Defense Relations" was drafted under the supervision of Michael A. Freney (Senior Fellow and Deputy Chief Operating Officer), assisted by Warren Zimmerman, Jr.

The entire study was prepared under the direction and supervision of George A. Carver, Jr. (Senior Fellow in Future National Issues) with the assistance of Sharon T. Calkins.

Executive Summary

History and geography have combined to forge a literally unique relationship between Canada and the United States, one more akin to a family partnership than to politico-diplomatic-military and economic alliances found elsewhere around the world.

Yet even happy families, particularly large ones, are never totally free of stress; and though the close, peaceful alliance between Canada and the United States is amazingly harmonious, it is neither untroubled nor ever totally free of friction. In recent years, this alliance has been both vexed and occasionally strained by a wide variety of diverse issues -- some very general, others quite concrete.

At the request of Canada's Business Council on National Issues (BCNI), this study focuses on three key issue and, at times, problem areas of major bilateral concern: trade and economic policy, energy, and defense. These issues are examined from a US perspective in order to give this study's Canadian readers "the view from the South". Our purpose is to help clarify these complex issues, enhance mutual understanding of them on both sides of our common (undefended) border, and thus facilitate serious, action-oriented discussion of them by private and public sector leaders in both nations.

Trade and Economic Policy

Two realities govern the structure of Canadian-US economic relations: the interdependence of the two economies and the vast differential in their size.

The level of trade between the United States and Canada currently exceeds that between any other two countries in the world. Each is the other's largest trade partner and also the greatest recipient of the other's foreign investments. Yet although this mutual interdependence creates mutual vulnerability, the stark asymmetry in the sheer size of these two economies results in a corresponding imbalance in their levels of respective vulnerability -- a fact which has long had many political and psychological ramifications as well as purely economic ones.

Particularly in the field of trade and economic policy, a period of chill in Canadian-US relations that lasted through the 1970s and into the early 1980s provides an important backdrop to the current situation. This bumpy period drew US attention to Canada and to developments in Canadian-US economic relations, but not always in helpful ways -- or ones welcomed north of the border. (US policy-makers, for example, became increasingly aware of what they considered Canadian protectionism.) Yet concern over perceived

changes in Canadian policy also led some in the US government and business community to begin defining an agenda that could improve matters in this sphere.

Canadian-US economic (and general) relations grew perceptibly warmer between 1982 and 1984 -- as the Trudeau government backed away from some of what were regarded south of the border as its more contentious policies. At the outset of 1985, prospects for Canadian-US economic relations appear unusually bright -- in no small measure because of Brian Mulroney's election as Canada's Prime Minister and Ronald Reagan's re-election as President of the United States.

The Reagan administration has made a clear commitment to improving and upgrading the US relationship with Canada; but our allies north of the border need to understand that this genuine commitment does not portend any kind of "grand design". Particularly in the sphere of trade, there is little sentiment in the Reagan administration -- or on Capitol Hill -- for creating new institutions to deal with economic relations.

At this juncture, trade issues are delicate -- particularly on the southern side of our common border. Though there is genuine US interest in liberalizing trade with Canada, the recent recurrence of Canadian interest in bilateral trade negotiations has the potential

for putting the Reagan administration in an awkward bind. As a matter of basic economic policy, the administration is committed to the use of market forces -- both internally and internationally. Also, the administration faces growing domestic protectionist sentiment, intensified by the widening US trade deficit of recent years. This is a particularly germane consideration because the US trade deficit with Canada (which reached US $15.6 billion in 1983) is second only to the US trade deficit with Japan -- a fact on which domestic US attention has not focused and which it is certainly not in Canada's interest to highlight.

On balance, for reasons discussed in our study, the United States is more likely to favor a comprehensive free trade arrangement than either a functional or a sectoral approach to trade liberalization -- partly because a comprehensive Canadian-US trade agreement would actually be easier to manage politically.

The present state of relations between the United States and Canada provides a real opportunity to resolve longstanding disputes and possibly to begin with new approaches to trade liberalization; but this fortuitous combination of factors may well prove to be temporary. Washington and Ottawa each has its own political and legislative timetables; and leaders in both capitals should recognize that if genuine forward movement in Canadian-US trade relations -- developing its own momentum and political constituencies -- is not established before congressional attention turns toward the US trade deficit, this window of opportunity may rapidly close.

Energy

In the energy field, relations between Canada and the United States have long been marked by both cooperation and contention. In the early 1970s, contention came to the fore; and in October 1974, Canadian-US relations in this sphere reached their nadir when Canada's National Energy Board, without consulting the United States, announced that it would phase out natural gas exports by 1979 and oil exports by 1981. Though these policies were subsequently modified, other thorny issues -- e.g. "acid rain", to cite but one example -- made the balance of the 1970s and the early 1980s a prickly period in Canadian-US relations. In the mid-1980s, however, a new atmosphere conducive to seriously addressing common energy problems has made it possible to shelve the sterile bickering of previous years.

During the 1980 Presidential campaign, both candidate Reagan and President Carter expressed interest in creating a "North American common market" for fuels and other goods; but this proposal was immediately rejected, not only by Ottawa but also by influential executives of domestic US oil and gas corporations (especially independents) who believed they had been unfairly treated by the Trudeau government. That oscillation symbolized a pattern that has

persisted to this day in the spheres of both oil and natural gas. Despite steadily improving "discussion atmospherics" in both the public and the private sectors, the oil and the natural gas situation has been, and remains, both complex and volatile -- much affected by domestic attitudes and developments in both Canada and the United States, by external developments beyond the North American continent, and by the dynamic interaction of all of these factors. Though progress has clearly been made in both spheres, major uncercainties becloud any assessment of future links between the United States and Canada in the natural gas sector, and the future of Canadian-US oil cooperation is also open to debate.

With regard to oil cooperation, or a special component thereof, for just over a decade (i.e., since 1974) there has been considerable interest in Canada's Maritime Provinces and in New England in the concept of some kind of a joint petroleum reserve -- an interest stimulated by the fact that both of these regions are proportionately more dependant on imported oil than the rest of their respective nations, and both are at the far end of their nation's domestic energy transportation systems. Discussion of this concept has included inevitable carping and static, on both sides of the border, but the idea of such a joint reserve merits serious consideration at the highest levels of the US and the Canadian governments.

For many years, US utilities have been major consumers of Canadian electricity. More than one hundred transmission lines -- capable of handling about 2 percent of US generating capacity and 14 percent of Canadian capacity -- currently link the two countries; and regional trade, especially in the US Northeast and Northwest, could rise dramatically in the next few years. The electricity sphere, however, is full of actual and potential static -- with "environmental" concerns constituting a particularly potent area of contentious dispute. It is in the interests of both nations to increase the level of their electricity trade; but the issues have become so complicated that in the absence of effective joint action by both governments, there is an acute danger that growing friction in bilateral relations over these issues will become difficult for anyone to control.

Over the next few years, water and water resources are clearly going to join oil, natural gas, and electricity as "energy issues" of increasing public and private sector concern and friction in both Canada and the United States, at both the national and the state or provincial levels. The eight US states and two Canadian provinces which border the Great Lakes, for example, have already banded together to resist the parched US Southwest's increasingly focused designs on Great Lakes water.

While the policies of the Mulroney government, and the Reagan administration's receptivity to them, augur well for enhanced cooperation in the energy and natural resources sector, both governments have much work to do in this sphere.

Defense

The Canadian-US defense relationship is firmly grounded in geographic proximity and common interest; but there are stresses in this relationship which need attention -- many of them deriving from what has long been regarded south of the border, and in NATO, as Canadian recalcitrance in defense burdensharing. Furthermore, both in NATO and in the context of defending our shared North American continent, there is a dynamic evolution in the Soviet threat -- both strategic and conventional -- and in the tactics and techniques being developed to counter and deter that evolving threat. These developments, in turn, mandate a re-examination of the defense postures of both Canada and the United States. Such a re-examination, fortunately, is already in train in Ottawa as well as in Washington. Furthermore, there are welcome signs in both capitals that a new period of convergent outlook and heightened co-operation in the Canadian-US defense relationship may now be possible.

The first priority of any Canadian government naturally is, and must be, the protection of Canada's sovereign territory and people from any attack or threat thereof. Canada is also an important member of the NATO alliance, however, and thus has an additional range of alliance-related defense responsibilities and commitments.

Over the past decade, for a variety of complex reasons, Canada's contribution to NATO (small improvements notwithstanding) has declined to the point where many defense analysts consider it negligible -- principally because in its NATO roles, Canada has spread itself too thin. Canadian Forces Europe (CFE) and the Canadian Air/Sea Transportable (CAST) Brigade Group are presently manned at levels far short of the NATO 90 percent required readiness strengths; and the Canadian Maritime Command (MARCOM) is not currently able to fulfill the missions now assigned to it.

Augmenting all three of these commands to adequate strength levels is naturally the best possible goal; but if this is not feasible, some policy-makers in Washington believe that Canada should consider scaling one of them back even further -- making it avowedly and purely symbolic, if not eliminating it altogether -- in order to upgrade the other two. Simply because of its small size (relative to other NATO force components), CFE is generally considered Canada's least strategically significant NATO contribution. The NATO (or at least SACEUR) view is that the assignment of the CAST Brigade Group

to the defense of Norway is Canada's most important potential NATO contribution; but there are those in Washington who believe that if CAST and MARCOM should have to be rank-ordered in priority terms, MARCOM is a strong candidate for top billing.

Canada's NATO role and the deployment of her defense capabilities and resources to meet it involve the fulfillment, or re-ordering, of previously accepted commitments. In contrast, the North American sphere of Canadian-US defense relations affords a significant opportunity for re-defining that partnership and fundamentally re-structuring Canada's role therein.

Although North American air defense will be in flux until the SDI debate is clarfied, if not resolved, upgrading our joint "North American" ability to provide advance warning of bomber and cruise missile attacks is clearly essential. Programs to do this are now being implemented under existing bilateral defense agreements and do not necessitate any basic modification of the structure of the Canadian-US defense partnership; but they represent a significant re-investment in North American defense over the next few years -- a re-investment which will have to continue as Soviet air-breathing programs develop and expand.

Burdensharing in the NORAD modernization program will thus be subject to constant re-negotiation. Such discussions are seldom

frictionless; and in particular, co-operation on the development of advanced technology applicable to the defense of North America continues to create neuralgia.

The most salient feature of the Canadian-US defense partnership in peacetime is the symbiotic bilateral defense trade relationship that has evolved with the strategic partnership. In recent years, Ottawa has been concerned about a balance of defense trade deficit (US $312 mn in 1984) that has favored the United States since 1976. Washington, however, does not consider Canada's defense trade deficit to be a major problem or sufficient justification for special consideration for Canada in US Department of Defense contracting decisions. This view is due to the overall 1:1.2 balance that has been maintained in Canadian-US defense trade over the past 25 years (better than any other US-foreign defense trade ratio), and the Washington position that the defense trade balance can only be analyzed in the context of the overall Canadian-US balance of trade, which favored Canada in 1984 by US $20 bn.

Another, equally complex issue that also affects the overall tenor of Canadian-US relations and has specific implications for Canadian-US defense co-operation is the thorny problem of offsets -- discussed in some detail in our paper.

From or through the offset thicket, the path of defense policy initiatives leads directly into the also complex areas of NORAD

modernization and Ballistic Missile Defense (BMD). Significantly greater investment in NORAD, as well as extensive new research and development efforts, are inevitable if any type of BMD is deployed in North America or intergrated into NORAD. These two factors have substantial but as yet unclear implications for Canadian-US cost sharing and cooperation throughout the whole range of Canadian-US defense partnership programs.

Within this decade, North American continental defense issues and questions will increasingly involve or focus upon outer space. The US debate over military space policy is bound to continue for many years, as the research results of SDI are analyzed. If Canada wants to benefit substantially from US military programs in space, however, Ottawa will have to define Canada's military space policy as soon as possible. From the US perspective, Ottawa must first decide on the degree to which Canada wants to or, in resource terms, can be involved in the development and production of space-based systems. Ottawa will then need to establish the extent to which Canada wants to be involved in the command and control of those systems that relate to North American defense. Though these are difficult and politically prickly decisions; for reasons explained in our paper, they need to be made promptly.

Basic defense policy decisions are never easy to make. They always involve a delicate, politically-charged balancing of conflicting interests, equities, threat perceptions and competing

resource claims. Such decisions, however, lie at the very core of national sovereignty, and are the ultimate, sovereign responsibility of any government -- particularly a democratically elected one. Our study concludes with a "prescriptive conceptual suggestion" on how Ottawa might build on the yeoman work on Canadian defense policy already done by the BCNI, among others, to develop an approach, for Canada, which only Canadians can -- or should -- pursue; but if followed, could be of enormously beneficial utility to Canada itself and to all of its allies, including the United States.

TABLE OF CONTENTS

I. INTRODUCTION

History and geography have combined to forge a relationship between Canada and the United States which is, quite literally, unique -- unmatched anywhere else on this planet. Though both Canada and the United States are diverse, heterogenous, sovereign nations, each independent and distinct, they share common cultural roots, inextricably intertwined. The most obvious manifestation of this phenomenon is their common language -- English, in its Canadian and "American" variants -- deriving from a shared eighteenth century British heritage; but there are many other historic ties less readily apparent. Louisiana's French-speaking "Cajuns", for example, are the descendants of Acadians driven from Nova Scotia after Wolfe defeated Montcalm on the Plain of Abraham; and other legacies of eighteenth century Franco-British rivalry and struggles in North America still abound on our shared continent -- particularly in bi-cultural Canada, but also in the United States.

This shared heritage, in turn, both reinforces and is reinforced by the impact and consequences of geographic propinquity -- which has long been uniquely peaceful. More than one hundred and

seventy years have passed since the sound of naval gunfire echoed across any of the Great Lakes, or the rattle of musketry was heard along rural byways such as Lundy's Lane. It may be a cliché to term the 5,000 odd mile frontier between Canada and the United States the world's longest undefended border, but it is -- and that fact alone speaks volumes about the relationship in question.

Similarly, it may be hackneyed to note that Canada and the United States are -- and long have been -- close, interdependent allies; but that is also true. Indeed, this alliance is much more akin to a family partnership than to conventional politico-diplomatic-military-economic-etc. alliances found elsewhere around the world.

The "family" analogy, however, also holds in other spheres. Even close and happy families, particularly large ones, are never totally free of stress. Similarly, though the alliance between Canada and the United States is close, peaceful and -- on the whole -- amazingly harmonious, that alliance is not completely untroubled; nor is it ever totally free of friction. Of late, within their own unique and distinctive parameters, relations between Canada and the United States have been quite vexed, even strained, by a wide variety of diverse issues ranging from very broad and general concerns about what is perceived on one side of the border, or both, as economic

and/or cultural insensitivity, to more concrete but nonetheless complex problems such as "acid rain", down to contention over the ownership of uninhabited rock outcroppings such as Machias Seal Island.

In the November 1984 "Throne Speech", the drafting of which was one of his first acts as Prime Minister and hence had the flavor of an inaugural address, Brian Mulroney -- through Governor General Jeanne Sauvé, speaking in the Queen's name -- made a pointed nod to the recent past by observing, and pledging, that "My Government has taken the initiative to restore a spirit of good will and true partnership between Canada and the United States."

With deft and doubtless deliberate emphasis, Prime Minister Mulroney implicitly overstated the situation; for good will and true partnership between our two nations has existed for well over a century and hence does not really need to be "restored". Nonthe-less, the Prime Minister's fresh and welcome tone, warmly reciprocated by President Reagan, augurs well for a new atmosphere in which needed and mutually beneficial improvements in the Canadian-US relationship will be perceptibly easier to discuss and then, perhaps, to implement than might have been the case in recent years.

It is in precisely this spirit that this paper was prepared and drafted. In it, we focus (by mutual agreement with Canada's Business Council on National Issues) on three key bilateral problem

areas -- trade and economic policy, energy-related matters, and defense questions -- which inevitably have a major impact on the whole tone, tenor and conduct of Canadian-US relations. We do so, frankly and candidly -- as was also requested by the BCNI -- from a US perspective. Our purpose is to clarify the issues involved, enhance mutual understanding of them on both sides of our common (undefended) border, and thus facilitate serious, action-oriented discussion of them by private and public sector leaders in both nations. In co-operative partnership with the BCNI, the kind of discussion we want to stimulate is that which engenders feasible new arrangements or other concrete steps that can further the stated common objectives of Canada's Prime Minister, the President of the United States, their respective governments and -- above all -- the people of our two allied nations who collectively comprise the family and family partnership involved.

II. TRADE AND THE US-CANADIAN ECONOMIC AGENDA

A. The Structure of US Canadian Economic Relations

Two realities govern the structure of US-Canadian economic relations: the interdependence of the two economies and the vast differential in their size.

Geographic proximity plus the similarities in income levels, cultural background, consumer tastes, and the general life-styles of

the two countries involved have made increasing economic interdependence a natural development. The movement toward closer links between the US and Canadian economies has been continuous and particularly pronounced since World War II. Bilateral trade has grown substantially, both absolutely and relative to each country's trade in other markets.

Today, the level of trade between the United States and Canada exceeds that between any other two countries in the world. Two-way merchandise trade was valued at more than US $90 billion in 1983. Two-way merchandise trade reached US $75 billion for the first two quarters of 1984 and was expected to top US $120 billion for the year. (If trade in services is included, the figure exceeds US $150 billion for 1984). Each country is also the other's largest trade partner. Indeed, if one does some numerical factoring, the second largest single US trade partner (after Canada) is the Province of Ontario; and the United States does more trade with the Province of British Columbia than with the entire People's Republic of China.

As Table I shows, the composition of US-Canadian merchandise trade has remained relatively stable since the 1970s. Manufactured goods dominate the two-way merchandise trade flows, although the US deficit in trade with Canada is mainly in nonmanufactured goods. Proportionately, raw materials account for a much larger share of US imports from Canada than exports to Canada. Nevertheless, raw and semiprocessed materials constitute a smaller percentage of Canada's

TABLE 1

US Merchandise Exports to Canada by End Use Commodity Category

	1970	1975	1980	1981	1982	1983
grand total (in millions of US$)	9083.8	21758.9	35395.3	39546.3	33720.2	38244.
foods, feeds and beverages (% of total exports)	8.2	5.4	4.6	4.4	4.8	4.3
industrial supplies and materials	24.2	25.7	29.5	28.0	26.6	25.9
capital goods	28.1	27.7	28.3	29.8	28.4	24.8
automotive goods	27.2	30.1	25.0	25.5	27.3	31.9
consumer goods	6.0	6.4	5.7	5.7	6.1	6.0
other	3.3	4.5	6.9	6.7	6.8	7.1

US Merchandise Imports from Canada by End Use Commodity Category

	1970	1975	1980	1981	1982	1983
grand total (in millions of US$)	11091.1	22752.3	41995.3	46826.7	46476.9	52129.7
foods, feeds and beverages (% of total imports)	5.8	4.1	4.2	4.3	4.9	4.6
industrial supplies and materials	46.9	53.7	57.8	55.5	50.0	47.9
capital goods	7.3	7.9	10.2	10.7	9.4	7.9
automotive goods	32.3	28.2	20.6	22.2	27.9	31.8
consumer goods	2.2	1.9	3.5	3.2	3.2	3.3
other	5.4	4.2	3.6	4.0	4.6	4.4

Source: FT 990, Highlights of U.S. Export and Import Trade, U.S. Department of Commerce.

TABLE I.A

Summary of the US Current Account with Canada

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984*
balance on merchandise trade	1826	- 10	-1371	-2746	- 330	-1071	-2066	-9198	-10546	-10616
balance on goods and services	4907	3933	4897	4375	8878	7660	7204	203	704	- 2646
balance on current account	4770	3805	4743	4240	8720	7461	7011	- 18	551	- 2772

*1984 figures include first three quarters only.

Source: Survey of Current Business, U.S. Department of Commerce.

total trade with the United States than with its other trade partners. Although data on trade in services remain elusive, the United States has traditionally run a surplus, offsetting some of its merchandise trade deficit with Canada.

Not surprisingly, direct foreign investment has closely followed trade between Canada and the United States. Canada is now the largest recipient of US foreign investment, with some 20 percent of the US total located there. Similarly, the United States is the largest single recipient of Canadian foreign investment -- with, significantly, more than 65 percent of that (Canadian) total.

Though mutual interdependence, in any sphere, often creates mutual vulnerability, the stark asymmetry in the sheer size of these two economies results in a corresponding imbalance in their levels of vulnerability. In terms of population, the United States is ten times larger than Canada; the US gross national product (GNP) is approximately eleven times that of Canada. In 1983, the United States accounted for slightly more than 70 percent of all Canadian imports and exports. In the same year, Canada accounted for only about 20 percent of all US imports and exports. US macroeconomic policies have a decisive effect on Canadian economic life and developments, but Canada's policies do not affect the United States to any similar degree. A 1974 Federal Reserve study found

that a change in US policy that leads to an increase in spending of 1 percent of GNP will, within three years, lead to a 0.86 percent increase in Canadian GNP. A similar increase in Canadian GNP will increase US GNP by only 0.13 percent over the same period.* These figures highlight the imbalance in the degree of vulnerability of the two economies, but the latter figure is comparatively significant because of ten industrialized countries studied, only developments in West Germany were found to have a greater effect on the US economy. To a large extent, the US business cycle defines, and has defined, the possibilities of growth in the Canadian economy. The US recovery that began in mid-1982 is no exception. Its effects were felt in Canada by the beginning of 1983 as US demand for Canadian exports fueled growth in the Canadian economy, helping Canada to recover from its deepest recession of the post-war period. (US imports from Canada increased by 12 percent in 1983.)

From the US standpoint, this combination of interdependence and asymmetry has had a number of important effects on the management of relations and on how US policy-makers tend to view Canada and Canadian affairs.

---

*Bert G. Hickman, "International Transmission of Economic Fluctuations," in International Aspects of Stablization Policy (Boston: Federal Reserve Bank of Boston, 1974).

First, the extensive web of political and economic ties between the two countries has resulted in a highly decentralized management of relations on the US side. At the federal level, for example, the US interagency coordinating group for Canadian affairs includes representatives from six State Department offices and three Department of Defense offices, plus the Department of Commerce, the Treasury Department, the Department of the Interior, the Office of the US Trade Representative, the International Trade Commission, the Environmental Protection Agency, and the United States Information Agency. The two governments interact at many different levels, from officially planned cabinet-level exchanges to the informal use of "direct dial diplomacy." Even more exchanges and discussions occur at the state and provincial level. The business communities in both countries also maintain their own contacts. And these various kinds or levels of contact are, at best, difficult to coordinate.

Second, the United States has long maintained a special relationship with Canada that acknowledges the close links between the two economies -- even if not to the extent that many Canadians might desire. The United States has repeatedly granted what it regards as special considerations to Canada in the trade area. In the fall of 1984, when the United States imposed restrictions on some steel imports, the Reagan

administration made extensive efforts to negotiate a separate agreement with Canada. Except on nuclear technology, there is no history of controls on US exports to Canada since World War II. The United States has also put a high premium on consultation with Canada, and on Canadian support for its initiatives, in multilateral fora such as the GATT and the OECD. Yet in consultation among allies -- particularly with respect to sensitive economic issues of vital concern to either, or both -- there is a strong analogy to beauty: quality, even adequacy, is often in the eye of the beholder.

Third, notwithstanding -- or even, sometimes, because of -- the special nature of the US-Canadian relationship, Canadian issues have not routinely or consistently received high-level policy attention in the United States. The large differential in size and the widely held assumption of basic mutuality of interests help account for a historic pattern of US "benign neglect" -- which Canadians may often find irritating, but which they should realize is a two-sided coin of considerable net value to Canada. It is certainly true that despite the strong effect of US domestic policies on the Canadian economy, Canadian concerns weigh lightly in calculations that determine the US fiscal and monetary policy mix, which is driven by and largely reflects US perceptions of US internal needs. Nonetheless, as Canadians should recognize, it is also the

case that the United States has never viewed Canada as a competitive threat in the way it has long regarded both the nations of East Asia and the European Community. Even though the US trade deficit with Canada (which reached US $15.6 billion in 1983) is second only to the US trade deficit with Japan, the "Canadian deficit" has not yet become a focal point of domestic US political attention -- perhaps because US $12.2 billion of this 1983 deficit was in raw materials and nonmanufactured goods, which are less politically visible than finished products.

Fourth, many US "Canadian experts" have gradually come to realize the extent of Canadian sensitivity to the spill-over effect of US domestic economic policies. This growing awareness of Canadian concerns has led segments of the US policy-making community to advise that the United States should adopt a reactive stance toward Canada with respect to economic policies, particularly those regarding trade liberalization, on the perhaps inaccurate but nonetheless widely held premise that any US initiatives are bound to be met with suspicion in Canada because of concerns over sovereignty. To the degree that such specialists have held sway, the Reagan administration has awaited Canadian proposals for the further liberalization of trade to avoid the appearance of trying to "subordinate" Canada.

In sum, the factors governing Canadian-US economic relations are complex; their interacting dynamics, even more so. The dominant factors remain the interdependence of the two economies and the asymmetry in their relative size. These two factors have provided the basis of a unique relationship; but the very closeness of the ties between these two economies has often constrained US policy in ways not necessarily helpful to either.

B. The Chill That Has Begun To Thaw

A period of chill in Canadian-US relations that lasted through the 1970s and into the early 1980s provides an important backdrop to the current situation. In the 1970s, Canada's policy orientation began to shift toward more active government intervention in the economy, with a concomitant increase in government regulation. This shift in Canadian policy was seen in the United States as largely reflecting a rising tide of touchy Canadian nationalist sentiment -- much of it directed against what then-Prime Minister Trudeau and his followers seemed to regard as the threatening and overbearing economic, political, and cultural weight of the United States. Post hoc is not always propter hoc, but such Canadian sentiments began to be perceptibly more evident (at least in the United States) soon after President Nixon's refusal to exempt Canada from the temporary import surcharge he established in 1971.

During these years, three Canadian actions came to be regarded -- south of the border -- as symptomatic of the phenomenon in question: (1) The administration of the Foreign Investment Review Agency (FIRA), which was created to screen new foreign investment in Canada but aroused US concern over its procedures, particularly export performance requirements, and the lack of any clear or consistent rationale in its decisions. (2) The establishment of the National Energy Program (NEP). (3) The development of the so-called "Third Option," which emphasized a long-term strategy to develop the Canadian economy in ways that seemed keyed to decreasing its vulnerability to the US economy.

This bumpy period in US-Canadian relations brought about two changes in US attitudes toward Canada that are both still operative. First, more attention was drawn to Canada and developments in Canadian-US economic relations; for as the relationship deteriorated, Canadian visibility within the United States increased. As US attention became more focused on Canadian-US economic relations, furthermore, US policy-makers became increasingly aware of what they considered Canadian protectionism. Canadian restrictions on border broadcasting and trucking permits, for example, aroused attention and frustration in the United States when Canada seemingly made little effort to resolve disputes over these restrictions.

Second, concern over such perceived changes in Canadian policy led some in the US government and the US business community to begin defining an agenda of items that could improve relations: namely, a freer flow of capital, less rigid rules governing foreign investment, and reduction of trade barriers. The United States exerted substantial pressure on Canada to make these improvements; but it was generally accepted in Washington that the direction of change should come from north of the border.

C. Prospects For Improvement -- A New Beginning

At the outset of 1985, prospects for Canadian-US economic relations appear brighter than they have appeared for some time. Canadian-US relations -- both specifically economic, and general relations as well -- grew perceptibly warmer between 1982 and 1984 as the Trudeau government backed away from some of its more contentious policies, especially the procedures of the FIRA and the NEP. This thawing trend was enhanced, and an even more positive situation created, by the September 1984 election of Progressive Conservative Party leader Brian Mulroney as Canada's Prime Minister and the November re-election of Ronald Reagan as President of the United States. There is now a pronounced convergence of policies and priorities in both countries, plus a growing sense that there is now a real prospect for an upward turn, even a new beginning, in their economic relationship.

From the US perspective, it appears that Canadians now realize that the policy orientation of the 1970s did not serve Canada's best economic interests. Prime Minister Mulroney has outlined an economic program that resembles President Reagan's in its fiscal restraint, has introduced legislation to revise FIRA substantially and has announced that the back-in provision of the NEP will be scrapped. Among other things, these changes suggest an effort to ease the entry of more foreign investors into Canada so that foreign investment can play a role in correcting the Canadian economy's problems. Prime Minister Mulroney's December 1984 speech before the Economic Club of New York reinforced US expectations concerning these points. This promise of a change of direction in Canadian policy has allayed some of the major concerns of the United States.

Simultaneously, the Reagan administration has made a clear commitment to improving and upgrading the US relationship with Canada. In September 1983, for example, the Reagan administration took the symbolically significant step of creating the position of Deputy Assistant Secretary of State -- a political appointment -- specifically for Canadian affairs. Since the September 1984 Canadian elections, President Reagan and Prime Minister Mulroney have had a very cordial meeting and agreed to meet at least once a year on a bilateral basis. US Secretary of State George Shultz and Canada's new Secretary of State for External Affairs Joe Clark have also met, and agreed to meet at least four times a year -- continuing an agreement initially established between Secretary Shultz and former External Affairs Secretary MacEachen.

This new commitment does not indicate any kind of a "grand design" for Canada on the part of the Reagan administration. The administration does not intend to create new institutions to deal with economic relations.* Its main focus, instead, has been to increase the number of senior level visits and to work more effectively within the existing framework.

These developments highlight a "window of opportunity" for progress in Canadian-US trade relations. From the US perspective, it is important to take advantage of the current convergence of the two governments' policies by making a renewed effort to resolve long-standing issues. On a practical level, US officials hope to settle nagging disputes in the trade arena such as border broadcasting, the issuance of trucking permits, copyright laws, pharmaceutical patents, liquor boards, and postal rates. The Reagan administration, however, has shown no indication of seeking to link any of these issues to each other, or to other items on the Canadian-US economic agenda.

---

*Senator George Mitchell (D-Maine) proposed the formation of an institution to oversee US-Canadian economic relations -- and aid in the resolution cross-border disputes. This proposal was included in the Senate version of the October 1984 trade bill but was dropped in the conference (final) version. To date, the administration has not supported this proposal.

Whether the currently favorable outlook for Canadian-US economic relations continues will depend mainly on two factors: the Mulroney government's performance -- i.e. in US eyes, whether or not it delivers on its promises -- and the establishment of forward momentum in the US-Canadian trade relationship.

D. Trade Liberalization

The issue of liberalizing trade between the United States and Canada is certainly not new. From the mid-1800s through the establishment of the Smoot-Hawley tariffs in 1930, Canada periodically initiated discussions with a view toward boosting the Canadian economy through greater access to the US market. During these seven odd decades, however, the United States tended to be looking inward, and did not prove receptive. Following World War II, it was the United States that initiated bilateral discussions -- as the US became involved in the establishment of a global trading system. The framework of an agreement was actually drawn up before the Mackenzie King government backed away from the pertinent negotiations in the spring of 1948. Since then, general progress has been limited, though the establishment of the Automotive Agreement in 1965 marked a significant sector-specific recognition of Canadian-US interests in liberalization of bilateral trade.

The recent recurrence of Canadian interest in bilateral trade negotiations has found the Reagan administration facing difficult pressures in the trade arena. On the one hand, the administration is committed to the use of market forces, both internally and internationally, as a matter of basic economic policy. On the other, the administration faces growing domestic protectionist sentiment, intensified by the widening US trade deficit of recent years. These developments, together with apparent frustration over the cumbersome GATT process, have led to an increasingly assertive US stance toward international trade negotiations. In 1984, US officials were widely expected to continue the multilateral focus of US postwar trade policy and concentrate their efforts on a push for across-the-board GATT talks involving more than one hundred countries. Instead, they have offered to negotiate selectively on a range of specific trade issues with any nation ready to begin negotiations. In making this potentially historic shift, the United States did not rule out another multilateral GATT round. Indeed, in his February 1985 State of the Union Address, President Reagan called on US trade partners to join in a new round of multilateral trade negotiations. Rather, Washington served notice that it is prepared to explore bilateral and other avenues to the trade agenda. Steps toward trade liberalization on a bilateral basis are not viewed by administration officials as incompatible with progress on a multilateral basis. On the contrary, movement with a select number of trade partners is widely regarded as creating positive pressure that will encourage broader mulilateral participation.

From the US perspective there could easily be significant advantages in negotiating further liberalization of trade with Canada through tariff reductions. Successive rounds of multilateral negotiations have substantially reduced the levels of tariffs between the two countries so that 80 percent of Canadian exports to the United States and 65 percent of US exports to Canada will enter duty free by 1987; but these figures do not take into account trade that does not occur because tariffs are too high and they tend to hide the fact that even where tariffs are low, they can reduce export growth. Even after the full implementation of the Tokyo Round tariff cuts in 1987, Canadian tariffs will remain significantly higher than those of the United States. This is particularly true for manufactured goods, which comprise four-fifths of US exports to Canada, where Canadian tariffs will remain approximately twice as high as US tariffs. (The average US tariff on manufactured goods will be 4 percent, while Canadian tariffs will average 9-10 percent. Moreover, tariffs for some sectors will remain as high as 20-25 percent.) Bilateral negotiations between the United States and Canada could also serve as an example to both countries' other trade partners and, thus, they might encourage further multilateral negotiations.

The idea of a functional approach to liberalization of Canadian-US trade has provoked some discussion on both sides of the border. The functional approach is perceived south of the border as

having more potential interest to Canada than to the United States. The functional approach concentrates on the removal of nontariff barriers to trade, while the United States continues to have a significant interest in further reductions in tariff levels.

Thus far, the only proposal on the table between the United States and Canada is the Canadian initiative to explore the feasibility of limited sectoral free trade arrangements similar to the Automotive Agreement. The Reagan administration welcomed this initiative as a positive step in the direction of trade liberalization; but the initial sectors proposed by Canada -- steel and urban mass transit equipment -- were perceived in the United States as cutting heavily in Canada's favor and a broader range of sectors was suggested. Joint working groups were established to review speciality steel, agricultural equipment and inputs, informatics, and government procurement practices related to urban mass transit equipment.

Although the United States will not rule out a sectoral approach to trade liberalization, a number of drawbacks to that approach are apparent. Discussions concerning only a limited number of sectors greatly diminishes executive branch flexibility in the negotiations. Sectoral arrangements also require some balance of advantages, which is always difficult to find, and the industry being hurt usually tries to block any such agreements. In theory, of

course, that industry is being crimped in return for other benefits; but to the parties directly and immediately affected, these benefits often seem more nebulous or ephemeral than the concrete "negatives" directly involved. This raises another important point: sectoral arrangements arouse specific special interests, engendering focused opposition and making any such agreement difficult to sell politically. Sectoral agreements also would require a waiver in the GATT, which would be hard to achieve.

On balance, the United States is more likely to favor a comprehensive free trade arrangement than either the functional or sectoral approach to trade liberalization. A comprehensive Canadian-US agreement, actually, would be easier to manage politically. It would allow for greater flexibility in negotiations and would be easier to present to Congress, as special interests would be less aroused. A full free trade agreement would also serve as a broad example on the international scene and would thus be more beneficial than any sectoral agreement in achieving an impetus for multilateral negotiations. There is an added advantage in that the negotiations for a US-Israeli free trade agreement provide a precedent for this type of discussion. A comprehensive agreement also would not require a GATT waiver.

Any agreement -- for functional, sectoral, or comprehensive free trade -- would, of course, need Congressional approval. In the final analysis, Congress is the controlling factor. The mood of the previous Congress was reflected in the trade bill passed in October 1984 that gave the President expanded authority in negotiating trade liberalization.* Congress then seemed favorably disposed and receptive to any positive developments toward liberalization on the trade front.

The working majority of the previous Congress remains substantially unchanged in the present Congress; and it is unlikely that the mood of the present Congress will differ greatly from that of its predecessor. Two points, however, should be made. First, this favorable situation will not hold true if US economic growth

---

*This trade bill, for the first time, gives the President specific negotiating authority with respect to international trade in services, US foreign direct investment and export performance requirements, and international trade and investment in high technology products.

The trade bill also provides the authority to enter a trade agreement eliminating or reducing US tariffs; this authority did not previously exist. The President had the authority, under section 102 of the Trade Act of 1974, to negotiate trade agreements to harmonize, reduce, or eliminate nontariff barriers.

continues to slow and US trade deficits continue to increase. It is virtually inconceivable that Congress will not address the huge US trade deficit at some point -- at which time, notice is bound to be taken of the $15 billion-odd trade deficit with Canada. Second, several key legislators, including influential Committee and Sub-committee chairmen, have local constituencies with specific trade complaints against Canada. The administration would like to see some progress in Canadian-US trade negotiations before Congressional attention turns toward the trade deficit. As Ottawa should recognize, demonstrable and tangible progress in this sphere would make it easier to stave off protectionist measures aimed at Canada, or measures that would affect Canada in ways Canadians would doubtless consider adverse.

E. Interim Conclusion

US-Canadian economic relations have reached an important juncture. The present state of relations between the United States and Canada provides an opportunity to resolve longstanding disputes and possibly to begin with new approaches to the issue of trade liberalization. The Reagan administration has served notice that it is willing to explore any opportunity to liberalize Canadian-US bilateral trade, and the Canadian government is currently reviewing various approaches. A number of factors have combined to create a "window of opportunity" for real progress in discussions between the

United States and Canada concerning trade liberalization: the strength of the recent US recovery -- and the fact that it is expected to continue, although with slower rates of growth -- has kept protectionist pressures containable; the Mulroney government has allayed US concerns over items that previously dominated the bilateral economic agenda; the two governments share a similar outlook on economic policy; and the US Congress, for the moment, seems favorably inclined toward progress on the trade front.

This fortuitous combination of factors, however, may well prove to be temporary. Washington and Ottawa each has its own political and legislative timetables; and leaders in both capitals should recognize that if genuine forward movement in Canadian-US trade relations -- developing its own momentum and political constituencies -- is not established before Congressional attention turns toward the US trade deficit, this window of opportunity may rapidly close.

III. PROSPECTS FOR US-CANADIAN ENERGY RELATIONS

A. The Background

US policymakers have historically viewed Canada as a land of "abundant" energy resources. Beginning in the 1950s, successive US administrations pursued an idea of a "continental" energy policy --

with Canadian energy in excess of Canada's domestic needs flowing to the United States. Canadians, not surprisingly, took a different view of the matter. While in the 1960s Ottawa supported the idea of integrating the two nations' energy markets, a continental approach to energy trade has never been the official policy of any Canadian government, and has in fact long been assailed by Canadian nationalists.

During the 1950s and 1960s however, both nations -- despite occasional contentious policy debates -- sought to remove impediments to the flow of oil and gas and to encourage their domestic production. In Canada, this led to a policy of exporting to the United States; in the United States, it kept Canada exempt from the Mandatory Oil Import Program until 1970. In 1973, the peak year of Canadian oil exports to the United States, Canada supplied 17 percent of US gross oil imports (about 1 mmbd). Then came OPEC's "oil shock" and the FIRA; and, by 1983, Canada was only exporting about 274,000 b/d of crude oil to the United States, which was still up from the almost negligible level of the late 1970s. (See Table II)

Even before the Arab oil embargo of October 1973, Canadian energy policy began to change in response to growing concern about the nation's resource base and enhanced alarm over how rising energy prices would affect the Canadian economy.* Canada's energy policy switched from protecting its market in the US to shielding its own

---

*Prices rose from 1970-1973; and in early 1973, this pattern of rising prices prompted President Nixon's second energy message.

Table II.

CANADIAN TRADE IN ENERGY AND RELATED PRODUCTS

1973-1983 in Canadian $Millions

	1973	1976	1979	1982	1983
Exports					
Crude petroleum	1,482	2,287	2,405	2,729	3,457
Other refined petro and coal products	477	1,120	2,721	3,807	4,129
Natural gas	351	1,616	2,889	4,755	3,958
Electricity	109	162	729	1,120	1,228
Radioactive ores	64	57	379	359	63
Total	2,483	5,252	9,122	12,769	12,835
Imports					
Crude petroleum	941	3,273	4,497	4,979	3,274
Other refined petro and coal products	375	769	1,260	1,794	1,887
Natural gas	8	9	--	1	--
Electricity	6	9	1	5	2
Radioactive ores	x	--	73	127	112
Total	1,331	4,060	5,831	6,906	5,276
Balances					
Crude petroleum	541	-986	-2,093	-2,251	183
Other refined petro and coal products	102	351	1,461	2,013	2,241
Natural gas	343	1,608	2,889	4,754	3,958
Electricity	103	153	728	1,114	1,226
Radioactive ores	64	67	306	232	-49
Total	1,153	1,192	3,291	5,863	7,559

Source: Economic Council of Canada, Connections: An Energy Strategy for the Future, 1985

consumers from expensive imports -- especially in Ontario, Quebec and the Maritime Provinces. In theory, markets were to be developed in the Canadian east for oil and gas from the western provinces. The federal government in Ottawa mandated an expansion of the domestic market, and insisted that new production preconditions be incorporated into new export contracts. Utilizing its executive powers to tax and to regulate national policy, Ottawa attempted to dominate energy policy making. This extension of central government authority, in turn, precipitated a row in federal-provincial relations over the question of how to resolve pricing and marketing issues that had previously been considered under the purview of the provincial governments.

In the energy field, Canadian-US relations reached their nadir when in October 1974, in response to OPEC's price hike, Canada's National Energy Board -- without consulting the United States -- announced that it would phase out gas exports by 1979 and oil exports by 1981. While the policy curtailing gas exports was modified in 1977-78 in response to higher assessments of the natural gas reserve base, oil exports after 1974 plummeted and refineries across the US northern tier experienced financial chaos.

Throughout the balance of the 1970s, other energy issues figured prominently, and contentiously, on the Canadian-US bilateral agenda. The key issues are well known and hence need only be flagged here: (1) growing concern about acid rain, believed in Canada to be principally caused by coal-burning utilities in the US midwest; (2) the US Government's failure -- despite the commitment of Presidents Nixon, Ford and Carter -- to move ahead on the Alaska Natural Gas Transportation System even after Canada decided, in July 1980, to permit construction of the southern portion of the pipeline prior to completion of the Alaskan portion; (3) Canadian and US environmental opposition to the construction of the Northern Tier Pipeline from Puget Sound eastward, designed to aid refineries hurt by Canadian oil export curtailments; (4) numerous maritime boundary disputes affecting fishing and offshore oil and gas exploration in the Atlantic and Pacific Oceans and the Beaufort Sea; (5) differences over the status of the waters of the Canadian Archipelago and the non-resolution of these disputes' impact on frontier oil and gas development and transportation to southern markets; (6) continued debate about the merits of a joint strategic petroleum reserve in Newfoundland and/or Nova Scotia that could aid oil import-dependent New England and the Maritime Provinces in the event of a crisis; (7) debate over the degree to which the United States should become dependent on exports of Canadian electricity (nuclear vs. hydro) and how such electricity should be priced; (8) the fluctuating taxation and foreign investment policies of the government of Prime Minister

Trudeau, which US energy companies viewed as particularly onerous and unfairly prejudicial to their existing investments; and (9) differences over US non-proliferation policy, especially during the Carter administration.

Individually and, even more, collectively, these thorny issues made the 1970s and early 1980s a very prickly period in US-Canadian relations, particularly in the energy field. Each such issue had its own concrete, individual aspects and background; but underlying them all were two more fundamental considerations -- one sagely noted by the BCNI in its own June 1984 study ("The Energy Imperative -- A Perspective on Canadian Oil and Natural Gas Policy"), the other rather tartly mentioned in the lead article ("Curing that deficit") of The Economist's 15 December 1984 edition.

--As the BCNI study observed, "The oil shocks of the 1970s created a widely-held expectation of ever-increasing crude prices. For oil producing countries like Canada, this expectation created a sense of opportunity ... Given this environment, it is not surprising that the oil and gas policy which emerged as the National Energy Program (NEP) was concerned mainly with wealth distribution rather than wealth creation. Because development seemed inevitable, there was little incentive to be concerned about new production, and every reason to focus on who would enjoy the benefits."

-- This happy mind-set was soon undercut by the cold reality which The Economist succinctly summarized: "In the 1970s, the United States was slower than any other big country, bar profligate Canada, to learn it was nonsense to try to keep fuel cheap."

By the mid-1980s, however, politically unpalatable facts of international and economic life were beginning to be faced in both Ottawa and Washington, in ways that made it possible to shelve the sterile bickering of previous years and created a new atmosphere conducive to seriously addressing common problems, particularly in the energy field.

B. The Reagan Administration: Canadian-US Energy Relations in Transition

1. Oil and Natural Gas

From the outset of his administration, President Reagan has been buffeted by conflicting forces which have had a profound impact on US-Canadian energy relations. During the 1980 Presidential campaign, both candidate Reagan and President Carter expressed

interest in creating a "North American common market" for fuels and other goods -- though this proposal was immediately rejected, not only by Ottawa but also by influential executives of domestic US oil and gas corporations (especially independents) who believed they had been unfairly treated by the Trudeau Government. Many of these companies had expressed their displeasure with Ottawa's foreign investment policies by pulling their drilling rigs out of Canada. When President Reagan fully decontrolled oil in late January 1981, energy producers transported their equipment from Canada in droves to take advantage of the higher prices offered in the United States. Nationalists in the Trudeau Administration saw this as an affront, thus further exacerbating relations.

Despite such surface tensions, and continued debate over the above-mentioned array of issues that had dominated earlier administrations, a series of events in the international energy market created a new climate in Canadian-US bilateral energy relations. By 1981, the rise in natural gas and oil prices as a result of the 1979-80 price shock, combined with increases in producer netbacks, had led to an acceleration in energy exploration and development in both Canada and the United States. Canada's decision to prebuild the southern portions of the ANGTS project also spurred drilling activity in the vicinity of the new pipeline; and as

just noted, Canada's foreign investment policies were at least partially responsible for the surge in drilling activity that occurred in the United States in 1980-81. Furthermore, the complexities of the NGPA in the United States encouraged the drilling of high cost gas which would not have been able to come to market in the absence of regulatory pricing policies. At the same time, the Fuel Use Act artificially held down demand for gas. The net impact of these events was a dramatic rise in natural gas reserves.

Then in 1981, in response to the deepening global recession and high energy prices, demand for oil and gas fell precipitously -- engendering a gas glut in the United States. As result, US firms in 1982 took delivery of only about 50 percent of the 1.5 TCF of Canadian gas authorized for export. By 1983, this had declined to 40 percent, meeting about 4 percent of US natural gas demand.

To further complicate the issue, early in 1983 Canada's federal authorities endorsed the National Energy Board's revised assessment stating that 11.5 TCF of gas could be exported over the next fifteen years. In response to these developments, in April 1983 Canada abandoned the 1980 Duncan-Lalande pricing formula, by which the single price of natural gas exports was linked to world oil prices, and cut the border price by 11 percent to $4.40/mcf. Despite subsequent attempts to hold prices up, in July 1984 Canadian Energy Minister Gerald Regan announced that starting November 1, Canada would effectively abandon price controls thereby allowing producers

to negotiate directly with US pipeline companies to ensure that their prices remained competitive with indigenous US gas and alternative fuels. Negotiated prices, however, remained subject to National Energy Board Review, based on certain established criteria.

With the election of the Mulroney government, this policy has gained momentum. Conversations with Canadian energy officials convince us that Ottawa hopes that a reduction in natural gas costs in Canada will reduce petrochemical feedstock costs, thus making its industry more competitive with the US. The Canadian government has announced, however, that in no case will it allow the average cost of its gas exports to fall below the cost of gas delivered to Toronto (approximately $3.10-3.15/mcf), though in some circumstances prices for spot sales could fall below $3.10. Inside Canada, the situation affecting natural gas prices is complicated by the fact that domestic gas prices are held at a level roughly equal to 65 percent of price-controlled domestic crude oil prices. While the government has acted to remove price controls, the domestic political ramifications of such a move could prove troublesome, given the inflationary impact that decontrol will inflict on the Canadian economy.

In assessing future links between the United States and Canada in the natural gas sector, six major uncertainties stand out. These center on (1) the extent and duration of the current gas surplus in the US and Canada; (2) the availability and price competitiveness of other supplemental gas supplies (e.g. the pipeline from Mexico and LNG); (3) the future market for Alaskan gas; (4) the relative price of Canadian gas exports vis-a-vis residual fuel oil and wood waste prices in the Pacific Northwest and New England, and indigenous natural gas and electricity prices; (5) the future demand and supply for natural gas in the United States. (6) divisions among high cost and low cost producers in the United States toward Canadian gas exports. High cost US gas producers are worrried that with the phasing out of the NGPA their interests could be jeopardized by cheap Canadian imports. Many US gas utility companies, however, favor Canadian imports out of concern over the long term availablility of US supplies.

The future of Canadian-US oil cooperation is also open to debate. While the policies of the Mulroney government toward oil-price decontrol, a profits-oriented taxation system, a revision of the foreign investment law, greater privatization of frontier development, and enhanced cooperation with the provinces in OCS development may lead to a mini oil boom, it is difficult to foresee a major long-term increase in conventional petroleum exports from Canada to the United States, barring truly sizeable discoveries.

In the short run, nonetheless, there are indications that Canada may become a more significant oil exporter to the US market. Partly because of its current surplus, supplies of light and medium crudes, and rising volumes of syncrudes, Canada exported nearly 335,000 b/d to the United States during the first half of 1984. While this figure is unlikely to rise at any time soon, given Canada's own domestic oil prices, Canada's tar sands reserves are vast; if a major new oil price shock made them competitive, they could play a vital role in meeting global needs after 1995.

2. Joint Petroleum Reserves

Ever since 1974, there has been interest in both the Canadian Maritime Provinces and in New England in the concept of a joint Strategic Petroleum Reserve, a Regional Petroleum Reserve, or a Defense Petroleum Reserve. Within the past two years, this interest has been reiterated by the Northeast International Committee on Energy (NICE, representing six New England states and five Canadian provinces) in a resolution calling for the "design of a plan for regional purchase, storage and allocation of crude and refined product in order to provide for the safety and security of the citizens of the region."

The need for a reserve stems from the fact that both regions are proportionately more dependent on imported oil than the rest of their respective nations, and both areas are at the far end of their

domestic energy transportation systems. While New England has no petroleum refineries, the Maritime Provinces have a huge shut-in refinery capacity as well as large storage facilities. Clearly there are synergisms between the two areas that deserve serious examination (though there is probably minimal need for building the new facilities that some proposals have called for). In recent months, this issue has heated up as a group of private investors have said they could finance the development of such a reserve in abandoned iron mines on an island off Newfoundland, which are especially suited to the storage of petroleum products in a working inventory. Such facilities could also serve as a Defense Petroleum Reserve for the two NATO allies in close, but safe, proximity to the European theater of operations.

US critics of these various proposals oppose the development of this particular reserve on the grounds that it is against the national security interest of the United States to have a reserve located in a nation that in 1973-74 cut back oil supplies to the United States volumetrically more than any member of OPEC. They also argue that US jobs would be exported. In addition, environmental critics in both Canada and the United States have opposed creation of a reserve because of the potential threat to the region's vast fisheries from expanded tanker traffic, oil spills, and pollution.

Despite inevitable carping and static, however, we believe that on balance the idea of a joint Canadian-US oil reserve merits serious reexamination at the highest levels of the US and the Canadian governments.

3. Electricity

For many years, US utilities have been major consumers of Canadian electricity. More than one hundred transmission lines -- capable of handling 11,800 megawatts (MW), or about 2 percent of US generating capacity and 14 percent of Canadian capacity -- currently link the two countries. Regional trade, especially in the US Northeast and Northwest, could rise dramatically in the next few years. Canadian utilities have long sold surplus electricity to US utilities on an interruptible or seasonal basis; and in a number of Canadian provinces, utility interests are now exploring the possibility of building new hydroelectric, nuclear, or coal-fired power plants dedicated for export.

Prospects for expanding Canadian electricity sales, however, are not unlimited. Canada does not yet have a fully interconnected power grid, and concentration on developing such a domestic grid is a major goal of Canadian nationalists who have supported the imposition of a federal export tax on electricity. Barring the building of dedicated plants, export sales could also be constrained by the growing domestic use of air-conditioning and by a seasonal peaking pattern similar to that of the United States.

While few Canadian officials at either the federal or provincial level have opposed making surplus capacity available for export, dedicating new capacity to the US market has engendered public and official opprobrium in both nations. Our understanding is that Canadian critics of new plants dedicated for export wonder why Canadians should bear the environmental costs for projects that primarily benefit south of the border "Americans". These critics ask what will happen in the future if estimates of further electricity growth again prove exaggerated and Canada is unable to sell its electricity. Although the anti-nuclear movement in Canada is far less active than in the United States, anti-nuclear critics on both sides of the border have expressed concern about the environmental, safety, and health impact of additional nuclear power plants. While these groups oppose all future nuclear development, Canadian organizations have insisted that the US government must accept all the waste generated if such plants are built in Canada to serve US needs.

The environmental community has also cited the growing "acid rain" issue as justification for not building any additional coal-fired plants generating electricity dedicated for the US market. Still other critics have urged that at a minimum, the decision to build dedicated export facilities should be linked to visible reductions in acid rain from US utility plants.

On the US side of the border, the issue is no less contentious. While some US utilities favor "exporting" the complex regulatory morass that prohibits timely construction of US coal and nuclear facilities, vendors of power facilities and other utilities oppose such a development because of the loss of US jobs and national security concerns. Such critics of greater reliance on Canada cite the National Energy Board's own figures to show that while exports may rise from 36.4 terawatt hours in 1983 to 45.6 terawatt hours in 1990, by 2005 Canada will have an export capability of only 24 terawatt hours. These critics fear that the export of the United States' electricity problem will dampen pressure for regulatory reform and will ensure a failure by the United States to build the additional 200-300 gigawatts (GW) of capacity projected by the US Department of Energy (DOE) as necessary by the year 2000.

In recent months, this problem has taken on a new dimension with the announcement by the Canadian government that its power from dedicated electricity-export plants should be priced at the highest avoided cost.* Outgoing US Energy Secretary Donald P. Hodel, former head of the Bonneville Power Authority, has considered Canada to be

---

* "Highest avoided cost" refers to the price of power that would have to be supplied in the absence of Canadian electricity. In New England, for example, the basis would be the cost of generating electricity by imported oil or nuclear power.

an unreliable supplier, given past Canadian actions in supplying the northwestern grid of the United States. Mr. Hodel also adopted the position that there is no reason why cheap hydropower from Ontario or Labrador should be priced at the highest avoided cost. The views of Mr. Hodel's successor -- John P. Herrington -- on these matters are not yet known; but since Mr. Herrington came from the White House staff, they are likely to be similar (if not identical).

Ironically, Secretary Hodel was supported by environmental groups in New England opposed to the Seabrook nuclear plant. Having defeated the construction of a number of nuclear facilities in the United States, the environmental community does not want to see nuclear plants built across the border in Canada. US environmental groups have also joined their counterparts in Canada in opposing some of the plans for large-scale hydroelectric development on environmental grounds. The environmentalists, in turn, have been joined by farmers in the Great Plains states who are opposed to the impact that large scale electricity transmission lines may have on the landscape and on their livestock.

While the current level of Canadian electricity exports seems too small (2 percent) to raise much concern, these figures belie the potential levels of dependency on Canadian electricity that certain areas of the United States might reach if all of the proposed

"dedicated" plants were constructed. In New England and the Northwest, then-Secretary Hodel expressed concern that levels of dependence could reach 20-25 percent, which he believed to be too high.

On balance, it is in the interests of both nations to increase the level of their electricity trade; but the issues have become so complicated that in the absence of high-level consultations and the enactment of broad policy guidelines by both governments, there is an acute danger that growing friction in our bilateral relations over these issues will mushroom out of control.

4. Water Resources

In recent months, water has joined petroleum and electricity as a potential source of friction in Canadian-US relations, particularly in the sphere of energy and resources.

A number of treaties and executive agreements currently regulate trans-border water issues; and to date, these accords have been collectively sufficient to settle past difficulties over water resources. For example, the 1909 Milk River pact -- in which that river's waters were shared along the Montana-Alberta frontier -- paved the way for the Boundary Waters Treaty governing the disposition of all joint water systems, plus the more specific agreement over Niagara Falls -- under which, the Niagara's water power is shared for hydroelectric purposes. In the future, however, such amicability cannot be taken for granted, especially in the context of broad resource disputes.

Unfortunately, water diversion and the pollution of lakes and rivers are likely to add to the growing list of bilateral resource conflicts between Canada and the United States. In this context, potential friction points include: water removal by the United States from Lake Michigan, which is itself US territory but is directly connected with the other Great Lakes, and such removal's effect on reducing the water levels of the other Great Lakes; the proposals emanating from Texas to build a north-south water pipeline in response to the growing depletion of southern aquifers; the current Poplar River dispute over US power plant construction, and the effects thus generated on the Canadian side of the border; the Garrison Dam water diversion; the possible mixing of watersheds from irrigation in North Dakota; and toxic dumping in the Great Lakes (now under examination by the US Environmental Protection Agency) that could well prove politically explosive in coming years should high toxic concentrations be uncovered.

Some of these issues may be eased but others may well be sharpened or exacerbated by the "Great Lakes Charter", signed in Milwaukee on 11 February 1985. This compact binds the eight US states and two Canadian provinces which have Great Lakes shorelines to notifying and consulting each other on any proposed major project for diversion or consumption of Great Lakes water. This new unity and harmony among the states and provinces bordering the Great Lakes, however, at least partly reflects "wagon circling" in the face of a common enemy and joint preparation for a confrontation with the US Southwest over Great Lakes water access and diversion.

C. The Summary Energy and Resources Outlook

While the policies of the Mulroney government, and the Reagan administration's receptivity to them, auger well for enhanced cooperation in the energy and resources sector, it is important for Canadians to understand that the legacy of previous Canadian administrations weigh heavily on the minds of many US energy executives. The curtailment of oil to the Northern Tier refineries, Ottawa's fluctuating trade and investment policies, changes in Canadian taxation laws, and most recently, unresolved issues in the electricity sector have raised questions in the United States about the realiability of Canada as an energy supplier -- despite the fact that some US interest groups and regions want to import more energy from Canada.

Such questions may be unwarranted, even unfair; but they exist, as do their potentially corrosive political consequences and impact. Enhanced and improved energy cooperation between Canada and the United States is clearly desirable, in the abstract, and can certainly be made mutually beneficial in concrete terms. Until both Ottawa and Washington establish clear and consistent policy guidelines for their bilateral "energy and resources trade", however, any given specific or particular agreement is bound to be assailed by a wide array of special interests on both sides of the border. Thus in this important sphere, as in several others, both the Mulroney government and the Reagan administration have much work to do.

IV. PROTECTING OUR SHARED CONTINENT: CANADIAN-US DEFENSE RELATIONS

A. The Essential But Sometimes Stressful Partnership: Background and Outlook

The Canadian-US defense relationship is firmly grounded in geographic proximity and common interest. In the United States, the concept of this close defense partnership is almost universally accepted and seldom challenged, though Canada has often been criticised for "neglecting her defense commitment". Over the past two decades, diminished Canadian defense budgets and resources have been the focus of this criticism, and a source of dissatisfaction both in Washington and in NATO councils. While the lackluster trend in Canadian defense spending has been marginally reversed over the past five years, many policy analysts in the Pentagon and State Department still privately consider Canada's defense contribution to be inadequate. At 2.1% of Gross Domestic Product (GDP), Canada currently spends proportionally less on defense than any other country in NATO except Luxembourg, and it maintains one of the lowest armed force to labor force ratios (again, second only to Luxembourg) in the alliance -- 1%. In 1983, in comparison, NATO countries on average devoted 3.7% of their GDP to defense spending and 2.6% of their labor forces to their military services.

Long frustrated by what has been widely regarded south of the border -- fairly or unfairly -- as Canadian recalcitrance in defense burdensharing, US policy-makers view the September 1984 election of the Mulroney government as a positive sign that a new period of convergent outlook and heightened cooperation in the Canadian-US defense relationship may now be possible. This defense partnership is currently in flux. There is clearly a fundamental similarity in the views on defense matters that Prime Minister Mulroney's government and President Reagan's administration have recently been expressing; but precisely how these convergent views will translate into actual policies or concrete actions is still obscure.

The new government in Canada and the defense review it will conduct throughout 1985 will doubtless articulate somewhat changed or modified Canadian objectives and priorities. Also, the debate currently underway in the United States about the feasibility and desirability of the Strategic Defense Initiative (SDI) will affect not only US, but Canadian defense perspectives as well. Furthermore, the obsolescence of NORAD air defense systems and the concurrent regeneration of the Soviet air-breathing threat will necessitate a reevaluation of US-Canadian cooperation in a variety of programs designed to provide strategic warning and defense for our shared North American continent.

In considering the Canadian defense policy that will evolve from the current review in Canada, US policy-makers have three overriding concerns:

First, in the US view, it is imperative that Ottawa either augment forces currently commited to NATO or -- if that is not economically or politically feasible -- rationalize Canada's NATO posture and role to levels more reflective of Canadian resource availability and political will.

Second, as the Soviet air-breathing threat to North America increases with the advent of long-range Soviet cruise missiles and the imminent production of the "Blackjack" intercontinental bomber, North American Aerospace Defense (NORAD) will become an increasingly critical area of the Canadian-US defense partnership. From the US perspective, continued cooperation in the current and future modernization of NORAD systems, as well as the resolution of existing problems in the attendant defense trade relationship, should be given a high priority in any Canadian defense policy.

Third, as the United States takes increasing account of the importance of military exoatmospheric systems, some in Washington feel strongly that Canada should define the parameters of its policy on, and role in, passive and active military operations in space. Decisions on these matters will have significant ramifications for defense development and production sharing, not to mention the most important consideration of all -- the defense of the North American continent.

B. NATO Roles and Obligations

Canada has a dual defense role, hence dual responsibilities, of a type with which the US is very familiar. The first priority of any Canadian government of course is, and must be, the protection of Canada's sovereign territory and its people from any direct attack or threat thereof. Canada is also an important member of the NATO alliance, however, and thus has an additional range of alliance-related defense responsibilities and commitments.

As will be more directly addressed below, the factors engendering changes in the Canadian-US defense relationship provide an opportunity for Canada to play an augmented role in the North American sphere of this defense partnership; but Washington policy-makers consider a restructuring or reform of Canada's NATO commitments to be her most important defense challenge and area of greatest potential contribution to overall allied strength. If there ever had to be a trade-off, immediate and direct threats to North America would naturally take precedence over NATO needs; but in the now-forseeable future, there is little likelihood of hostile action directly threatening the North American continent or, hence, Canada's sovereign territory. In the US view, consequently, NATO should be given priority over North America in the near-term investment or allocation of Canada's defense dollars -- particularly since with

Canada's purchase of CF-18 airplanes and its participation in the current modernization of NORAD warning and surveillance systems, Canada is essentially fulfilling its commitment to the "common defense" of North America. That is not the case with respect to NATO.

More specifically, ever since Prime Minister Trudeau's April 3, 1969 announcement of a 50% phased reduction of Canada's NATO forces and a three-year defense budget freeze, Canadian credibility in NATO, small improvements notwithstanding, has declined to the point where many defense analysts describe Canada's NATO contribution as negligible. The importance of Canada's three year success in meeting NATO's three percent target growth rate in defense spending is mitigated by the very low base from which these Canadian increases began. There is a general view in Washington that given the scope of Canada's force commitments to NATO and her present economic situation Canada should take steps to "rationalize" her effort in NATO.

In the United States, there are as many varying views on what Canada should try to accomplish in NATO as there are uniformed and civilian defense analysts in the Pentagon, the State Department and elsewhere. There is no currently apparent institutional pressure to

meld a unified US Government view or position on this matter, particularly since the Reagan administration has no desire to dictate defense policy to the new Mulroney government -- or run any risk of seeming to be doing so.

The Practical Feasibility of Current Commitments

Nonetheless, there is a strain of thought that is consistently present in US discussion of Canadian NATO policy. While no one with any NATO-related official responsibility ignores the symbolic importance of a Canadian presence on the European continent, many US analysts question whether Canada has given sufficient attention to the actual strategic value of the way in which her contribution to NATO's defense is currently structured. Canadian Forces Europe (CFE) and the Canadian Air/Sea Transportable (CAST) Brigade Group are presently manned at levels far short of the NATO 90% required readiness strengths, and probably not capable of 30 days of operations in European contingencies. In addition -- as stated in the May 1983 report of the Canadian Senate Sub-Committee on National Defense (Canada's Maritime Defence), and amply documented therein -- the Canadian Maritime Command (MARCOM) is not currently able to fulfill the missions now assigned to it.

In abstract theory, augmenting all three of these commands to adequate strength and readiness levels is naturally seen as the best possible goal, but it is patently one involving a considerable

investment. In more practical terms, if Canada chooses not to pursue or is unable to achieve this objective within a reasonable time frame, some policy-makers in Washington believe that Canada should consider scaling back one of her NATO commitments to upgrade the other two. From the US perspective, such a reform is achievable and distinctly preferable to Canadian maintainence of all three commitments at less than adequate strength.

Views inevitably differ over which Canadian NATO commitments should receive priority. Most US analysts assert that Canada's CAST Brigade Group (designated for deployment to Norway on the northern flank in the event of real or anticipated hostilities) and MARCOM (designated for antisubmarine warfare (ASW) to protect NATO's sea lanes) represent Canada's most significant strategic commitments to NATO. Without in any way casting aspersions on or, even less, denigrating the professionalism, dedication and bravery of the officers and other ranks involved, Canadian Forces Europe are generally considered less strategically significant because they constitute such a small minority of the NATO forces stationed in Europe (approximately 5,400 of a NATO total of over 2 million). NATO Supreme Commander General Bernard Rogers has articulated the NATO view that Canada's assignment of the CAST Brigade Group to the defense of Norway is Canada's most important potential NATO contribution; but many analysts on this side of the Atlantic are not obliged to support this NATO command position and do not necessarily subscribe to it.

Control of sea lanes between North America and Europe is a NATO priority on everyone's scale. In the event of hostilities, NATO stocks of military equipment could be depleted within as little as two or three days. The bulk of equipment and resupply would have to come by sea. To control vital sea lanes, NATO navies will have three principal responsibilities: the establishment of ASW barriers at crucial chokepoints, such as the Greenland-Iceland-United Kingdom Gap, to contain the burgeoning Soviet submarine fleet; wide area search and destroy missions; and point defense of high value convoys.

The North Atlantic Treaty Ogranization has a significant shortage of destroyers and frigates to meet these responsibilities. Even with its accelerated shipbuilding program, the United States Navy will be unable to overcome this shortage. Thus, an expansion of MARCOM would be regarded in Washington as a significant Canadian contribution to the objective of keeping NATO sea lanes open. In addition, an expanded MARCOM would serve direct Canadian interests, and directly protect Canadian sovereignity, through the surveillance and control of Canada's territorial waters. For such reasons, there are those -- including some of the drafters of this paper -- who feel that if CAST and MARCOM should have to be rank-ordered in priority terms, MARCOM is a strong candidate for top billing.

Canada's MARCOM currently maintains 20 destroyers (16 of which are ill-equipped for modern warfare), 3 submarines (used chiefly as mock targets for ASW practice), 18 long-range Aurora anti-submarine patrol aircraft, 18 short-range fixed wing aircraft, 35 anti-submarine helicopters, and a variety of support craft. In addition, Canada is procuring 6 new City-class patrol frigates, which will be premier ASW ships.

Canadian speculation on the possibility of eventually constructing 12 new frigates is extremely well received in Washington. Some US analysts, however, believe that Canada should go further. Procurement of 18 City-class frigates and additional Aurora patrol planes over the next decade could enable MARCOM to shoulder a substantial portion of the frigate/escort duty in the North Atlantic. The costs of such an expansion would be high (approximately C$12 bn for the 18 City-class frigates and C$2 bn for 18 additional patrol planes); but several direct Canadian interests, as well as crucial NATO objectives, would be served. Moreover, procuring additional City-class frigates, which are constructed in Canada, would generate much needed employment, plus stimulate widely beneficial Canadian research and development. Although the Auroras are built mainly in the US, Lockheed -- the prime contractor -- has already agreed to let significant subcontracts go to Canada as a condition of the sale.

Other Germane, NATO-Related Considerations

At least in public discourse, US defense analysts are reluctant to leave the level of broad objectives and recommend specific Canadian defense initiatives or action steps; but in private US discussions, points such as the following are often raised:

-- The continuation of air-launched cruise missile (ALCM) testing in Canada is deemed extremely important by Washington policy-makers. Canadian testing permits more realistic system evaluation and enhances confidence in operational ALCMs. Moreover, Canadian support for ALCM testing in Canada is seen as an important endorsement of the NATO deployment of cruise missiles on European soil.

-- Increased Canadian airlift capability is essential to the credibility of Canada's commitment to move Canadian based forces designated for operations in Europe.

-- Current Canadian discussion of strength levels and positioning of existing forces in Europe is welcomed in Washington. Present 58 percent manning levels of Canada's European-based formations are seen as evidence of a lack of a serious Canadian ground commitment. It is widely recognized, however, that this is offset by the important ongoing modernization of Canadian air elements.

C. NORAD --- Canada's Role In Direct Continental Defense

Canada's NATO role and the deployment of her defense capabilities and resources to meet it can be portrayed or discussed as involving the fulfillment, or re-ordering, of previously accepted commitments. The North American sphere of Canadian-US defense relations, in contrast, affords a significant opportunity for re-defining that partnership and fundamentally re-structuring Canada's role therein.

Although North American air defense will be in flux until the SDI debate is clarified, if not resolved, the current inadequacy of NORAD's warning and surveillance systems, along with the imminent deployment of long-range Soviet cruise missiles and the new Soviet "Blackjack" intercontinental bomber, will certainly require continuing attention. In his 1984 report to the Congress, US Secretary of Defense Caspar Weinberger noted that NORAD surveillance systems would have difficulty detecting bombers penetrating at low altitudes or through gaps in radar coverage. Hostile air breathing systems could therefore be used to prepare North America for a pre-emptive ICBM attack by striking command and control centers or even, perhaps in the future, ABM systems. Moreover, this danger is magnified by the concurrent rejuvenation of the Soviet air-breathing threat, manifest in the production of intermediate range "Backfire"

bombers at the rate of 30 per year, the future deployment of cruise missiles (the air-launched AS-X-15 and the sub-launched SS-NX-21 will have ranges of 3,000 km. and will probably be deployed in 1985), and the nearly completed development of the "Blackjack" bomber.

Upgrading the North American ability to provide advance warning of bomber and cruise missile attacks is essential. This objective is being pursued under guidelines set out in the US Defense Department's North American Air Defense Master Plan, which currently involves the following major programs:

-- deployment of Over-the-Horizon Backscatter radars (OTH-B) to provide advance warning from the east, south and west;

-- construction of a North Warning System (NWS) to replace the aging DEW line;

-- acquisition of AWACs;

-- fighter/intercepter modernization.

These programs are being implemented under existing bilateral defense agreements between Canada and the United States, and in the US view do not necessitate any basic modification of the structure of this partnership. Nevertheless, they represent a significant reinvestment in defense for North America over the next few years.

This reinvestment will undoubtedly continue as Soviet air-breathing programs develop and expand.

Burdensharing in the NORAD modernization program will be subject to constant renegotiation. Matters currently under discussion in this context include:

-- Sharing of procurement costs for North Warning System (NWS) Long Range and Short Range radars;

-- Funding of construction and communications capabilities for radars in Alaska and Canada;

-- Sharing of closure costs for the obsolete CADIN-Pinetree radar system in Canada, which the US believes should be phased out by FY '88;

-- Sharing of NWS operating and support costs.

Such discussions are seldom frictionless; and in particular, co-operation on the development of advanced technology applicable to the defense of North America continues to create neuralgia. Indeed, the US is willing to make this a permanent agenda item of the annual Defense Production Sharing Arrangements Steering Committee.

One of the most complex and difficult problems in connection with NORAD is the sensitivity of the sources of intelligence information necessary for early warning. A variety of US systems, many of them space-based, are highly classified and the information from them severely compartmented, even among US collectors, analysts, and operators. The extent of sharing of compartmented information within the context of defense co-operation is subject to continuing re-evalution. This subject is highly contentious even within the US government's defense and intelligence community and will doubtless also be a bone of contention in Canadian-US relations for the foreseeable future. The precise nature of these difficulties can not be discussed in an unclassified document, or dealt with in an open forum. Nevertheless, they need to be flagged because they affect not only the concrete bargaining which occurs with respect to burden sharing but, indeed, the whole overall tenor of Canadian-US defense relations.

NORAD Modernization and Ballistic Missile Defense

A US decision to deploy some type of BMD, and a Canadian decision to participate actively in its development, deployment and operation, could precipitate significant changes in NORAD's role and the level of investment required to sustain that new role. Implementation of any BMD system in North America would clearly

require North American air defense to include not only advance warning and surveillance but also an active defense, exoatmospheric or otherwise, against air-breathing systems. As Maj. Gen. John A. Shaud, director of plans for the US Air Force, said recently, "If you're going to fix the roof, you don't want to leave the doors and window open."

Significantly greater investment in NORAD, as well as extensive new research and development efforts, are inevitable if any type of BMD is deployed in North America or integrated into NORAD. These two factors have substantial but as yet unclear implications for Canadian-US cost sharing and co-operation throughout the whole range of Canadian-US defense partnership programs. While the BMD decision is pending, the United States is likely to pursue the present course of NORAD modernization -- badly needed in any event. If BMD development and deployment gets folded into the equation, NORAD will probably undergo the most significant and extensive restructuring since its inception.

D. Canadian-US Bilateral Defense Trade

The most salient feature of the Canadian-US defense partnership in peacetime is the symbiotic bilateral defense trade relationship that has evolved apace with the strategic partnership. Since 1959, the year that statistics were first kept, Canada and the United States have maintained a bilateral trade ratio of approximately 1:1.2. This ratio has been more consistent and balanced than any other US-foreign defense trade ratio.

Furthermore, through the Permanent Joint Board on Defense (PJBD) and the Defense Development and Defense Production Sharing Arrangements, the United States and Canada have established a unique defense trade framework that hedges against Canadian development of redundant defense industrial capabilities vis-a-vis the United States and aids both countries in the support of their respective defense burdens. Washington policy-makers stress that from the US perspective, the framework of the Canadian-US defense trade partnership is fundamentally sound, due to its flexibility, and does not require any substantial modification.

As in any close relationship, however, there are sources of tension which require communication and clarification. The most persistent source of tension over the history of the Canadian-US defense trade partnership has been fluctuating defense trade balances. Since 1976, the balance has swung in favor of the United States and consequently has become a source of Canadian concern. In response to this development, analysts in the Pentagon make two points. First, they note that, as mentioned above, the overall defense trade ratio between Canada and the US has remained remarkably balanced over the past two and one half decades. Furthermore, substantial US offset concessions, which often involve non-military commerce, are not reflected in the Canadian-US balance of defense trade statistics. Second, policy-makers emphasize that the defense

trade balance can not be analysed except in the context of the overall Canadian-US trade balance. As the following figures indicate, in recent years Canada's defense trade deficit has been relatively insignificant in comparison to the US deficit in overall trade with Canada.

Recent Trade Balances

	Defense		Overall	
	$US	Favors	$US	Favors
1982	+331 mil	US	+10 bn	Canada
1983	+192 mil	US	+15 bn	Canada
1984	+312 mil	US	+20 bn	Canada

In light of these figures and the relatively balanced nature of Canadian-US defense trade, policy-makers in Washington do not feel that Canada has been put at a net disadvantage by the recent defense trade balance in favor of the United States (annual defense trade from 1959-1976 favored Canada; since 1976 bilateral defense trade has favored the US). Moreover, some Pentagon analysts have expressed irritation at persistent Canadian requests for more Department of Defense contracts to mitigate the Canadian defense trade deficit.

Policy-makers stress that the Canadian defense trade deficit, at least for the near term, will not be considered a valid rationale for increased US Department of Defense contracting in Canada; collateral improvements in the balance of defense trade are desirable in any Canadian-US defense collaboration but will not serve as a significant factor in Washington policy-making.

Regardless of US attitudes toward the Canadian defense trade deficit, analysts emphasize that Washington is sensitive to the Canadian desire for a more interactive defense trade relationship. Three specific points are raised in Washington with regard to improving the Canadian-US defense trade relationship:

-- First, the Defense Development Sharing Arrangement (DDSA) currently limits Canadian-US burdensharing of military contracts in Canada to prime contracts. The United States has suggested in informal discussion that the DDSA be expanded to include Canadian-US burdensharing in subcontracts, which constitute a substantial portion of Canadian military contracting. Such a change would require more overall investment from the Canadian government, but would be an important incentive for the US Department of Defense to undertake more military contracting in Canada. Additional US subcontracting in Canada could have significant -- though largely unquantifiable --

benefits in terms of employment and technology transfer. Such a provision could be easily controlled from the Canadian perspective through the establishment of a maximum ratio of subcontracts to prime contracts and by strictly limiting burdensharing ratios (Canadian-US burdensharing in defense production is currently limited to a maximum disparity of 75 percent to 25 percent; a provision on subcontracts in the DDSA, for example, could limit Canadian contributions to 50 percent if need be).

-- Second, the United States supports high-technology trade with Canada in principle, but must see safeguards on Canadian industry and exports that are parallel to those imposed in the United States. Canada recently has agreed, in principle, to equivalent safeguards, and policy-makers in Washington indicate that their implementation and enforcement will increase the flow of technology to Canada. A specific example of technology with which the United States would be more forthcoming, following concrete evidence of stringent Canadian safeguards, is the Very High Speed Integrated Circuit (VHSIC). The VHSIC represents the most advanced US technology. The United States has invested approximately US $500 million in its development. Consequently, US industry is reluctant to share it and the Reagan administration is reluctant to risk it. Due to these factors, which are applicable to other forms of US technology, Canada must take

the initiative in establishing that it can reliably and consistently share US advanced technology; cultivation of sufficient trust will succeed, not just through rhetoric, but through performance. In addition, US analysts maintain that increased Canadian willingness to invest money in the research and development of high-technology programs would result in increased high-technology trade between the US and Canada. These guidelines apply to US policy on high-technology trade with any US allies; but policy-makers stress that due to the magnitude of US-Canadian defense trade (and US-Canadian trade in general), Canada stands to benefit more from improvements in these areas than do the other US allies.

-- Third, Washington is currently in what one Pentagon analyst terms a "make love to the Canadians" mood as a result of the September 1984 election and subsequent rhetoric from the Mulroney administration. Present US policy is to be as flexible and forthcoming as possible with regard to Canadian defense concerns in an effort to facilitate implementation of Canadian defense reforms. This mood, however, will only be sustained by concrete progress in Canada toward a stronger defense posture. Thus, 1985 could be termed a "honeymoon" year in Canadian-US defense relations; significant opportunity will result from implementation of positive Canadian initiatives, while cynicism will accompany unfulfilled Canadian rhetoric.

The Offset Thicket

A complex issue, which generally affects the overall tenor of Canadian-US relations and has specific implications for Canaadian-US defense cooperation, is the problem of offsets.

"Offset" is an umbrella label encompassing coproduction, licensed production, countertrade, subcontracting, and technology transfer. Some form of offsets are often mandated as a condition of sale by foreign governments purchasing military, or other, equipment from US contractors. The US government currently plays five roles in offset or offset/contract negotiations (seller in foreign military sales (FMS), active negotiator, observer of negotiations, approver of export licenses, and purchaser of foreign products); however, the US government does not guarantee offset arrangements signed by US companies. Furthermore, the Department of Defense has generally opposed such agreements unless they are absolutely necessary to complete a transaction, are deemed to be in the best interest of the United States, are cost effective, and result in a mutual reduction in barriers to trade. US government and Defense Department reasons for adopting this somewhat ambivalent posture include:

-- the management complexities and resource drain on the Department of Defense in negotiating and implementing compensatory coproduction/offset agreements;

-- the fact that offset agreements have the effect, or create the impression, of obligating the US government to place orders for systems or components in foreign countries, or of requiring the Department of Defense to force US contractors to do so;

-- a conviction that offset commitments are business judgements which should not involve the Department of Defense; and

-- a conviction that once commitments are made by industry, the US defense contractors -- not the Department of Defense -- should assume responsibility to the foreign government for fulfilling the promised offset.

In the past two years, however, US government analysts have become increasingly concerned by the growing number of offset agreements. Critics maintain that offsets negatively distort the US balance of trade, and also undermine US industry competetive-ness when they involve the transfer of advanced technology to other countries. On the other hand, proponents of offsets argue that the United States has benefited from offset arrangements, not only through the economic returns from the contracts involved, but also through the additional security provided by the enhanced

defense-industrial base of its allies. In addition, supporters of offset agreements maintain that offsets enhance the rationalization, standarization and interoperability (RSI) of allied forces because the prevalence of offsets tends to give large, established defense corporations a competetive edge.

Regardless of the variety of views expressed about offsets, one fact remains clear -- there is virtually no data base from which to analyze their actual impact. Consequently, Congress -- in conjunction with the Departments of State, Defense, Commerce and Treasury, and the Office of the United States Trade Representative -- is conducting a review over the next few years to accumulate a data base, assess the impact of offsets on the US economy, and determine whether direct US government supervision of them is warranted.

This review and any policy that might result from it are particularly relevant to Canadian-US defense trade because of the widespread recognition of the fact that Canada is the greatest single beneficiary of US offset agreements. A Department of Treasury report dated May 24, 1983, noted that of 130 offset contracts collectively worth US $9.55 billion and signed by 26 major US aerospace and electronic equipment manufacturers between 1975 and 1981, Canada had the largest share of offset arrangements in terms of both numbers

of contracts (28) and dollar value (US $4.6 bn).* Moreover, the attention being focused on Canada over offsets has been intensified by the offsets to the CF-18 sale, estimates of which run up to $3 bn or more than 110 percent.

US industry attitudes were also solicited by the Treasury for its report. Although it is difficult to gauge the potential impact of these perspectives on US government policy, the following points are particularly relevant:

-- the most frequently perceived negative consequence of current offset practices was that they involve technology transfer which potentially provides assistance to foreign competition;

-- the companies indicated that they faced US competition for 66 percent of the contracts that resulted in offset arrangements; foreign competition in 50 percent of such contracts; and indicated that, without offering offsets, they would have lost their contracts 75 percent of the time;

-- 66 percent of the US companies thought that multilateral agreements to limit ofsets would be advantageous and 75 percent felt that unilateral action by the US government would be disadvantageous;

---

* In comparison, second place Japan received only US $ 1.1 billion. Of the 28 contracts 15 were military and 13 were commercial. However, regardless of the relatively equal split between military and commercial, the military contracts reaped the lion's share of the gross worth of the offsets (US $4.26 billion in offsets related to military contracts, as opposed to US $.37 billion in offsets related to commercial contracts).

-- 70 percent of the companies indicated that they are in favor of a US government policy of demanding credits for its purchases abroad, with the credits to be applied toward reducing the offset requirements imposed on US industry.

Offsets, of course, are not limited to defense-related procurement contracts; and this is hence a broad, chiefly private sector, trade problem, not just a defense issue -- although, of 130 contracts involving offsets cited in the Treasury study, 94 percent were military (74 percent involved military aircraft). No US government policy is likely to be promulgated in the near term to deal with offset arrangements generically; hence for the immediate future, defense offset arrangements will probably remain the responsibility of US defense contractors and the prerogative of procuring governments. Nonetheless, Canada's persistent pursuit of substantial offsets in Canadian-US defense trade, often facilitated by competition between two or more potential US suppliers, has had a decidedly negative impact on US attitudes toward defense trade with Canada. Some US government analysts, as well as industry representatives, feel that Canada exploits the relatively open nature of US-Canadian defense trade, and the lack of a US offset policy, in exacting numerous and large offset agreements.

We are dealing here with atmospherics and attitudes, difficult to describe with precision and impossible to quantify. General US

dissatisfaction over Canadian offsets, however, does have some impact on US behavior and policy. Canadian exaction of offset arrangements from US firms, which some US industry representatives and government policy-makers regard -- fairly or unfairly -- as excessive, helps engender a bias against the free inclusion of Canadian industry in the precontracting process. This is a subject about which both Ottawa and Washington need to display more perceptive sensitivity than either currently shows. In particular, Canada needs to recognize that from the US perspective, offsets are an important source of tension affecting the whole Canadian-US defense relationship.

E. The Military Use of Space

Within this decade, North American continental defense issues and questions are likely to expand further across the "new frontier" of outer space.

In 1982, the United States' military budget for space ($6.4 billion) exceeded NASA's budget ($5.5 billion) for the first time; and in March 1983, President Reagan announced the Strategic Defense Initiative (SDI) to assess the feasibility of deploying a "leakproof" BMD, which would almost certainly require the deployment of active military systems in space. In his March 1984 report to the Congress,

Secretary of Defense Caspar Weinberger proposed spending $3.79 billion on SDI research and $130.6 million on space development and procurement in 1986 (as opposed to a total of $488.9 million on air defense development and procurement). By the end of this decade, the Pentagon will have conducted ground, airborne and space experiments to assess the possibilities of infra-red sensing and imaging radar technologies, as well as determining whether lasers and particle-beams, etc., can achieve sufficient lethality to destroy attacking missiles. Among the many currently unresolved questions here involved are the extent to which US systems will be active or passive, and the degree to which Canada will participate in these new ventures.

From the US perspective, Canada will need to make two decisions connected with the debate over military use of space. Ottawa must first decide on the degree to which Canada wants to or can be involved in the development and production of space-based systems (passive and/or active, offensive and/or defensive) and determine what resources Canada will be able to devote to such purposes. Ottawa will then need to establish the extent to which Canada would like to be involved in the command and control of those systems that relate to North American defense.

The US debate over military space policy is bound to continue over the next decade, as the research results of SDI are analysed. If Canada wants to benefit substantially from US military programs in space, however, Ottawa will have to define Canadian military space policy as soon as possible. This is necessary for two fundamental reasons:

(1) President Reagan has approved a Unified Space Command -- to be headed by an officer of four star rank designated CINCSPACE -- to integrate command over all US military space assets. The creation of such a command gives an institutional impetus to the consolidation of North American space assets under a US command structure. Bureaucratically, this is now a moving train, already picking up both speed and momentum. The effective time window for a meaningful Canadian conceptual or organizational input, consequently, is fast closing.

(2) A prompt Canadian commitment to substantial participation in the development of military space programs will allow Canada to bring her industrial resources and capabilities to bear in the early stages of the programs' research and development phases, helping assure continued Canadian involvement. Moreover, due to the expense and lead time required in any space program, it will be easiest for Canada to get involved in US space initiatives during their nascent stages. In addition, there is a latent bias in the Pentagon against allowing substantial Canadian participation in space-related programs for which the US has provided the seed money.

In Washington, it is generally felt that Canada will want to play a significant role in all aspects of SDI that relate to North

American defense; but here, there is some Washington ambivalence of which Ottawa should be aware and mindful. It is generally acknowledged that the US Defense Department will want to -- and should -- offer Canada some meaningful role in SDI; yet nonetheless, as one Pentagon officer put it, "If the Canadians decide that they want to play an active defense role in space, they will need a power play to overcome parochial opposition from industry and government in the US."

At this point, a delicate and prickly issue flagged above comes back into play. The primary concern policy-makers in the Pentagon stress when discussing Canadian involvement in the research, development and production of space-based systems is that of technology transfer. SDI and other space-related initiatives involve the most sensitive and highly classified technology current. The Reagan administration will continue to place a high priority on stemming the flow of US technology to the Soviet bloc. Consequently, US confidence that Canada can protect advanced technology will be a critical element to significant Canadian participation in SDI research and development.

In addition, Canada's limited budgetary resources -- which contrast sharply with the enormous expense of space-based programs and the variety of other defense commitments that Canada is attempting to meet -- make some US policy-makers wary of extensive Canadian involvement in space-related activities. Here again, things

get very delicate. SDI and space defense-related co-operation between Canada and the United States clearly merits and requires careful exploration by both governments. To be frank, however, there is a quiet reluctance in Washington to facilitate Canadian involvement in US military space programs unless and until Canada either (a) fulfills its current primary defense commitments to NATO, or (b) re-structures its NATO commitments to make them ones Canada then can, and does, fulfill.

Obvious budgetary constraints, however, are certainly no insuperable bar to Canada's playing a meaningful role in these new programs and endeavors. The Canadian aerospace industry clearly has much to offer any space initiatives. Many analysts point to the success of the shuttle arm in stressing that Canadian involvement in the development and production of space technologies can be mutually beneficial to both Canada and the United States. Further evidence of Canada's potential to benefit any US military effort in space is Canada's own civil space program, which is rapidly expanding and involves extensive co-operation with the United States in the deployment of a permanent space platform.

Moves by the Mulroney government to increase military research and development (5 percent of the military budget in 1984-85, compared to approximately 3 percent previously) are welcome and at least tacitly acknowledge the capacity of Canada to participate in both endo-and

exo-atmospheric initiatives now under consideration or in train. Close cooperation between Ottawa and Washington in setting pertinent terms of reference and then putting the relevant programs in optimum, agreed priority order will be essential to maximize the benefits of this effort for all involved.

F. A Prescriptive Conceptual Suggestion

In its own yeoman work on Canadian defense policy and the complex issues related thereto, the BCNI has adopted the commendable conceptual approach highlighted by the title of its September 1984 position paper, "Canada's Defense Policy: Capabilities versus Commitments".

As that study noted:

> "Despite significant acquisitions of some major replacement equipment, it is fair to say that the Canadian Armed Forces have clearly been subject to benign neglect and an inadequacy of resources for almost twenty years."

And as the BCNI study argues,

> " a considerable effort will be required to bring Canada's Armed Forces up to a level of strength that will permit Canada to meet effectively its existing military obligations and alliance commitments."

The drafters of this paper are naturally diffident (as all non-Canadians should be) about recommending how our sovereign ally should restructure its internal policies -- even ones relating to common interests such as defense. Nonetheless, we would suggest that Canadian public and private sector leaders might profitably consider refining and extending the BCNI's conceptual approach.

In this imperfect world, individuals and nations adopt "defense policies" -- with all thereby entailed -- to protect themselves against current or potential threats. The best defense policies and the most effective ones -- by every canon, including cost effectiveness -- are hence those most closely and realistically keyed to the current or potential threats with which the individual or nation in question is actually faced. As the national level, there is thus obvious conceptual merit in the formulation, development or revision of any government's defense policies begining with a rigorous, rank-ordered analysis of the threats, of all kinds, against which defense is or realistically may be needed by the nation in question.

No defense (or any other) policy can be perfect, and no wise or prudent one is immutable; for sound policies are keyed to concrete circustances, which inevitably change over time. For any given nation at any given time, an optimum defense policy is likely to be one that is at least partially "threat driven" -- not solely

determined or shaped, in the first instance, by any calculus of resources or, even less, by short run political calculations of the resources it is convenient or expedient to devote to defense at the time in question.

In its September 1984 study, the BCNI has already laid the groundwork for developing and articulating the conceptual approach here suggested by noting (at that study's outset) that "Canada's defence policy and military commitments must be formulated with the evolving global strategic situation in mind", then going on to observe (accurately):

> "Over the past two decades or so, the most salient trend in this area has been the steady erosion of the West's strategic position as the Soviet Union and its allies have increased their military power."

Implicitly, the BCNI study accepts a thesis apparently considered so self-evident as to need no explicit development or argument: that Canada faces no threat from across its undefended southern border with the "lower 48" contiguous United States, or its equally undefended western border with Alaska. Instead, the chief potential current threat against which Canada -- along with its NATO allies, including the United States -- needs to develop and maintain a deterrent military defense comes from the Soviet Union.

Explicitly, the BCNI study directly addresses a contrary thesis, which "evidently has appeal in some quarters" -- the belief "that neutrality would somehow insulate Canada from threats to its security and permit the reduction or even elimination of defence spending and military forces in this country". As the BCNI study notes, for reasons it then goes on the explain: "Examination of the arguments typically advanced in support of neutrality, however suggests that the benefits would prove elusive, and the risks high".

Pursuing the conceptual approach to defense policy here suggested would entail building on foundations the BCNI has already laid. The first step would involve a rigorous Canadian analysis of the Canadian interests which need or may need protection, and the threats against which Canada now needs or realistically may need to be defended. In many respects, such an analysis need only expand work already done or in train in Ottawa -- as illustrated by the following passage in the BCNI's September 1984 study:

> "Canada has extensive maritime interests and an enormous coastline, but the country's maritime forces have declined drastically over the past twenty years. At present, they are manifestly incapable of fulfilling their several key responsibilities: protection of Canada's maritime interests and sovereignty through control of territorial waters, defence of North America in cooperation with the United States, and defence of the NATO sea lanes of communication between North America and Europe."

A rigorous analysis of the Canadian interests requiring protection and the realistic threats against which those interests may need to be defended can then be developed into a meaningful inventory of true defense requirements -- i.e., an assessment of how Canada can best protect these interests and defend against these threats out of an optimum mix of her own capabilities, augmented where necessary or advisable by the capabilities of allies or alliances. All of these choices and decisions, however, carry inescapable price tags -- the defense utilization of Canada's own capabilities carries an inevitable resource allocation price tag, and augmenting these by enlisting the capabilities of alliances or allies entails accepting additional price tags for various kinds and levels of such external commitments.

No nation is wealthy enough to defend itself -- particularly out of its own domestic resources -- against all conceivable or imaginable threats; but any nation which fails or refuses to devote whatever resources are truly necessary to defend it against genuine threats -- including the resources necessary to preserve needed alliances and allies -- does so at its peril.

The balanced, often difficult judgments and decisions here necessary require statecraft of the highest order; making and then implementing them astutely is the fundamental responsibility of any government -- particularly any democratically elected government. It

is from precisely such basic decisions and judgments that sound, effective defense policies are most likely to flow; but developing, even privately, the requisite realistic, clear-eyed and hard-headed inventory of true threats and resultant defense requirements is a task few democratically elected government find comfortable and many consider politically or economically impossible -- as the history of the 1930s makes all too abundantly and tragically clear.

This is a type of analysis to which friends and allies can make inputs or suggestions, but which, ultimately, each nation and government must make for itself -- for such analysis and the basic policy decisions resulting from or influenced by it lie at the very core of national sovereignty and sovereign responsibility.

For Canada, consequently, this is an approach which only Canadians can, or should, pursue. Yet if followed in Ottawa, this approach could be of enormously beneficial utility to Canada herself and to all of its allies, including the United States.